

WPS 1719

POLICY RESEARCH WORKING PAPER

1719

Shifting Responsibility for Social Services As Enterprises Privatize in Belarus

David Sewell

In former command economies, such as Belarus, the process of enterprises shedding their "social assets" is seen as necessary to the transition to a market economy. The problem—for social policy in transition economies—is whether and how to continue supplying those social services after enterprises no longer provide them.

The World Bank
Europe and Central Asia Region
Technical Department and Country Department 4
February 1997



Summary findings

Sewell argues that in Belarus the term “enterprise social assets” is just about always a misnomer for fringe benefits that were part of the normal wage bargain with employees and were a rational response to labor shortages and constraints on wage offers in the old command economy. Firms in market economies respond similarly to the same incentives, and the continuing favorable tax treatment of benefits explains much of their continued importance, in Belarus and elsewhere.

Between 1994 and 1995 those benefits, as a portion of employee remuneration in Belarus, were cut by at least two-thirds. The economic downturn then contributed to a relative decline in benefits, particularly those involving capital expenditures such as housing construction and maintenance.

Large enterprises provided more benefits than other firms, and the quality of services provided by enterprises was considered superior to those provided by the government. In other economies of the former Soviet Union enterprise costs for these services have also been found to be higher because of the substantially higher salaries paid to employees who provided these services.

Whether most of those benefits should still receive public subsidies or preferential tax treatment is debatable. A case can be made for some government funding of public health and kindergarten services. It is also essential to find alternative sources of housing and public

utility services. As much as 25 percent of unemployment in transition economies has been attributed to labor immobility arising from lack of housing.

Local infrastructure is clearly a responsibility appropriate to local governments. In Belarus assigning services such as education and health care to local governments is more debatable.

Methods of financing local services also need to be addressed. The central government shares its revenues with local governments based on the area where the revenues are collected, but such revenue sharing inherently leads to more resources going to wealthier regions. Moreover, the subnational share of government revenues has declined, from 70 percent in 1992 to 48 percent in 1996. The earmarked taxes levied on enterprises to pay for housing maintenance and kindergartens are not justified because no close link exists between beneficiaries and payments. In fact, too much use is made of earmarked taxes in Belarus. And the taxes levied by subnational governments raise insignificant revenues.

Cost recovery from users should finance local utilities. Belarus also needs effective real estate taxes to finance local government services to property; current land use taxes cost more to administer than they raise in revenues. Where transfers to local governments are required, Sewell recommends formula financing.

This paper — a product of the Technical and EC4 Departments of the Europe and Central Asia Region — is part of a larger effort to find solutions to the problems of transition in the economies of this region. Copies of this paper are available free from the World Bank, 1818 H Street NW, Washington DC 20433-0001. Please contact Constance Lawrence, room H7-092, telephone extension 32216, fax 477-0686, internet address clawrence@worldbank.org (31 pages).

The Policy Research Working Paper Series disseminates the findings of work in progress to encourage the exchange of ideas about development issues. An objective of the series is to get the findings out quickly, even if the presentations are less than fully polished. The papers carry the names of the authors and should be cited accordingly. The findings, interpretations, and conclusions expressed in this paper are entirely those of the authors. They do not necessarily represent the view of the World Bank, its Executive Directors, or the countries they represent.

Shifting Responsibility for Social Services As Enterprises Privatize in Belarus

David Sewell

SHIFTING RESPONSIBILITY FOR SOCIAL SERVICES AS ENTERPRISES PRIVATIZE IN BELARUS

TABLE OF CONTENTS

	Page
Abstract.....	iii
Background.....	1
Analysis of Enterprise Social Spending.....	2
Comparisons with Provision of Fringe Benefits in OECD Economies	6
Reasons for Enterprise Spending on Social Assets.....	7
Priority Problem Areas: Utilities, Housing and Crèches/Kindergartens.....	11
Future Governmental Responsibility for and Financing of Divested Services.....	12
Divested Services: Whose Responsibility?.....	12
Responsibility for vs. Delivery of Divested Services.....	13
Local Government Finance: Problems and Solutions.....	13
Sources of Local Government Finance and Trends Over Time.....	14
Weaknesses of Revenue Sharing: Rural Local Governments and Stability of Transfers.....	15
Extrabudgetary Funds	16
Potential Sources of Finance.....	17
User Cost Recovery.....	17
Property and Real Estate Taxes.....	18
Appropriate Forms of Central Transfers to Local Governments in Belarus	18
Continued Partial Financing or Bridge Financing of Services and Enterprises	19
Conclusion	19
Appendix A: The Relative Burden of Wage Taxes in Belarus, the OECD, and the EU.....	22
Appendix B: Autonomous Sources of Revenue for OECD Local Governments: Property vs. Income Tax.....	24
Table 1 Belarus: Composition of Enterprise “Social” Expenditures, 1995.....	3
Table 2 Belarus: Composition of Employee Remuneration by Size of Enterprise/Sectors, 1995.....	4
Table 3 Belarus: Composition of Employee Remuneration by Oblast, 1995.....	5
Table 4 Sources of Subnational Government Revenues and Share of Subnational Government Revenues in the Central Government Budget	14

Table 5	1996 Revenue Sharing in Belarus	
	Share of National Taxes Allocated to Central and Subnational Budgets.....	16
Table 6	Comparative Importance of Local Income and Property Taxes, Selected	
	OECD Countries, 1990	25
Bibliography		26

Shifting Responsibility for Social Services as Enterprises Privatize in Belarus

David Sewell ¹

Background

1. Firms in Belarus spend on many functions classified as "social" in their enterprise accounting. Examples are housing for employees, summer camps for the children of employees, spas for employees, health and dental clinics on site and specialized medical and dental facilities off site, subsidized food, crèches and kindergartens, and vocational schools. In some localities firms also provide local infrastructure such as district heating, electricity and water and sewer reticulation. Extensive provision of such local infrastructure may have been particularly common by state and collective farms.
2. It has long been asserted that the "divestiture" of such "social" functions is critical to improving the competitiveness of enterprises in transition economies. It might well be added that enterprise "divestiture" of such "social" functions is equally critical to appropriate functioning of governments in the transition economies. Enterprises and government should be responsible and accountable for different and distinct sets of functions. Achievement of these goals is impossible if enterprises share vague responsibilities for social functions and are repeatedly subject to pressures to provide such functions by means of unfunded government mandates. Obviously, such a system of financing social objectives is not transparent, allows both parties to evade hard budget constraints, and thereby obscures and dilutes accountability to enterprise owners and the electorate.
3. In transition economies, the state also has to consider whether it wishes to continue to directly fund some of these social functions if enterprises discontinue their funding. If government is to be involved in continued provision of these services, the appropriate level of government has to be chosen for the purpose and the function should be adequately funded. The objective of this paper is to examine these issues as they apply to Belarus and suggest appropriate policy actions.
4. The Russian Government was the first to ask the World Bank for assistance with respect to enterprise social asset divestiture in early 1994. Since then, the Bank has undertaken several loans in support of enterprise divestiture of functions such as housing, kindergartens, medical care, enterprise privatization and related issues in social protection programs in Russia, Kazakhstan, and the Kyrgyz Republic. Staff Appraisal Reports for these loans are a rich source of information on this problem. As well, an extensive published literature is being built up on the issue. Aggregate surveys of the problem have been undertaken for specific countries by authors within and outside the Bank,² and are complemented by in

¹ This document was produced as part of the author's responsibility in the 1996 Belarus Country Economic Memorandum Mission headed by John Hansen. I wish to thank Elena Klochan, Nikolai Lisai and Konstantin Senyut of the World Bank's Resident Mission in Minsk, and John Hansen and Yuliya Merkulova for assistance in preparing this report. I have also benefited from specific comments from Jorge Martinez-Vasquez and Richard Bird, and from extensive discussions at the Bank with Lev Freinkman and Philip O'Keefe, both of whom are engaged in operations work associated with this issue.

² See Adrienne Cheasty, "Social Divestiture in Ukraine—A Budgetary Perspective," IMF Fiscal Affairs Department, Oct. 1995; Simon Commander and Richard Jackman, "Providing Social Benefits in Russia: Redefining the Roles of Firms and Government," Policy Research Working Paper 1184, Economic Development Institute, The World Bank, 1993; Simon Commander and Une Lee with Andrei Tolstopiatenko, "Social Benefits and the Russian Industrial Firm," Joint Conference of the World Bank and the Ministry of Economy of the Russian Federation, *Russia: Economic Policy and Enterprise Restructuring*, June 1995; Lev M. Freinkman and Irina Starodubrovskaya, "Restructuring of Enterprise Social Assets in Russia," Policy Research Working Paper 1635, The World Bank, August 1996; Jorge Martinez-Vasquez, "The Challenge of Expenditure-Assignment Reform in Russia," *Journal of Environment and Planning*, Vol. 12, 1994, pp. 277-

depth surveys in particular fields such as kindergartens,³ housing,⁴ and asset divestiture in problem industries and regions.⁵ We shall draw on this literature as appropriate in our own study of Belarus, and attempt to augment it in areas which, in our opinion, have not received as much attention, such as the implications for local government and the interactions of enterprise provision of these functions with the tax system.⁶

Analysis of Enterprise Social Spending

5. Tables 1-3 use enterprise statistics in Belarus to examine characteristics of spending on employee remuneration and “social development” and “social benefits” by type of benefit, size of firm, sector of the economy and region. In addition, but not shown in the tables, the relative size of enterprise spending on these fringe benefits was compared for the years 1994 and 1995. It was also reported to us that there are systematic differences in fringe benefits available to different occupations; some occupations such as teaching allegedly receive fewer fringe benefits. Our enterprise data did not allow us to examine such occupational differences, however.

6. There are measurement difficulties. Most importantly, data on some types of user cost recovery are incomplete, such as, for instance, where fees are collected for use of facilities such as kindergartens. This imparts a downward bias to comparisons over time, since user cost recovery has been increasing for housing and utilities as a result of government policy and indeed is required as a condition of loans to Belarus by the IMF. A further factor impeding comparisons over time is that data on the important category of housing maintenance undertaken by enterprises was not collected in 1994.

7. With these qualifications in mind, four components of employee remuneration and enterprise spending on social functions are distinguished in Tables 1-3: wages; other monetary payments to employees (such as bonuses and retirement allowances); enterprise spending on “social development” functions (primarily construction and maintenance of housing, infrastructure and facilities for sports, culture, and education); and other “social benefits” which consist of enterprise spending in kind taking such forms as subsidized meals, transport fares, medicines, etc. In Tables 2 and 3, we have aggregated firm spending on “social development” and “social benefits” to show a separate category of employee remuneration, namely non-monetary remuneration or fringe benefits.

292; Mark E. Schaffer, Richard Jackman, Gaspar Fajth and Judit Lakatos, Martin Rein, Irina Tratch and Andreas Woergoetter, “Round table on ‘Divestiture of social services from state-owned enterprises,’ ” *Economics of Transition*, Vol. 3 (2), 1995.

³ See for instance Jeni Klugman, Sheila Marnie, John Micklewright and Philip O’Keefe, “Enterprise Divestiture of Kindergartens and Childcare Arrangements in Central Asia,” in Jane Falkingham, Jeni Klugman, Sheila Marnie and John Micklewright (eds), *Household Welfare in Central Asia*, (Macmillan, UK, forthcoming 1996).

⁴ See Robert M. Buckley and Eugene M. Gorenko, “Unwinding the Socialist Wage Package: The Role of Housing in Russia,” World Bank (TWURD), Dec. 1995; “Russian Enterprise Housing Divestiture,” Urban Institute Research Paper, 1995.

⁵ See Patrick Bodnar, Lev Freinkman, Vladimir Lexin and Alexander Shvetsov, “Russia: Financing and Maintenance of Social Assets Divested from the Coal Industry,” World Bank (EC3C2), June 1996.

⁶ I have used three sources for information on the tax system in Belarus: Richard M. Bird and Thomas Tsiopoulos, “Taxation and the Development of Private Enterprise in Belarus,” EC4C1, May 1994; Mick Keen, “Tax Reform in Belarus: Preliminary Report on Economic Aspects,” EU Tacis, April 1996; and L. A. Khankevich, “The Taxation System in the Republic of Belarus,” EC4C1, June 1996.

8. Table 1 gives a breakdown of the types of spending by firms on "social" functions or nonmonetary remuneration in 1995. Expenditures on social development made up 75 percent of the total, with this category of spending dominated in turn by expenditures on maintenance of housing, infrastructure and social facilities, which accounted for 53 percent of all nonmonetary remuneration of employees. Unfortunately, no breakdown of expenditures on construction by type of facility is available, but housing makes up the largest category of expenditures on maintenance of facilities, accounting for 14 percent of total nonmonetary remuneration. It is also of interest that maintenance of infrastructure, such as repair of heating plants, made up a further 12 percent of total "social" spending by enterprises.

9. Finally, enterprise spending on "social benefits," or subsidies in kind which do not include construction, maintenance or financing of special events, made up 25 percent of all "social" expenditures by enterprises. These "social benefits" included subsidies for such things as commuting and food. The transportation subsidies were and are important in tight housing markets. The importance of food subsidies is seen in the fact that food expenditures in 1995 accounted for 62 percent of consumer budgets in Belarus—ten times as much as the next largest category of consumer expenditure, which was clothing.

10. Enterprise provision of many of these social benefits in former Soviet Union countries has been observed to be superior in aggregate to that available to other members of the public.⁷ To an outside observer, differences in provision of nonmonetary benefits are most evident by size of enterprise, however. The dental benefits provided by a large enterprise such as Belarus Railways greatly exceed both in quality and availability those extended to the ordinary member of the public through state clinics.

11. Aggregate statistics support this observation that enterprise spending on fringe benefits is systematically correlated with size of firm. As can be seen in Table 2, the quartile comprised of the largest

Table 1: Composition of Enterprise "Social" Expenditures, 1995

	<i>Billions Belarusian Rubels</i>	<i>Percent</i>
Expenditures on Social Development	2,649,653	75
Construction of Facilities	609,512	17
Maintenance of Facilities	1,864,250	53
Health	267,135	8
Social Insurance	133,177	4
Sports	65,134	2
Education	294,840	8
Culture	88,289	2
Housing and Infrastructure	917,359	26
Housing	484,891	14
Infrastructure	432,468	12
Special Events	175,891	5
Health and Sports	100,442	3
Education and Culture	39,606	1
Expenditures on Social Benefits ¹	890,876	25
Total Expenditures on Social Development and Social Benefits	3,540,529	100

¹ Subsidies in kind to employees such as subsidized food, vouchers for transport, etc.

Source: Ministry of Statistics, Republic of Belarus

⁷ "Enterprise kindergartens were considered to be superior in quality to municipal facilities, and these differentials appear to have persisted: 1994 data for Kazakhstan show per child expenditures in enterprise kindergartens to be twice that in those run by the Ministry of Education." Klugman et al., "Enterprise Divestiture of Kindergartens and Childcare Arrangements in Central Asia," pp. 3-4. In another 1995 study for the Bank by ADB Associates, it was estimated that adoption of municipal standards would reduce total kindergarten costs in the Kyrgyz Republic by 20%. Cited in Freinkman and Starodubrovskaya, "Restructuring of Enterprise Social Assets in Russia," p.24.

Table 2: Composition of Employee Remuneration

<i>By Size of Enterprise, 1995¹</i>					
<i>Type of Remuneration</i>	<i>Highest Quartile % of Total</i>	<i>Second Highest Quartile % of Total</i>	<i>Third Highest Quartile % of Total</i>	<i>Bottom Quartile % of Total</i>	<i>Grand Total (%)</i>
Wages	70%	81%	88%	96%	74%
Other Monetary Payments (Bonuses, etc.)	15%	12%	8%	2%	14%
Total Monetary Remuneration	85%	93%	96%	98%	88%
Expenditures for Social Development	11%	4%	2%	1%	9%
Expenditures on Social Benefits	4%	3%	2%	1%	3%
Total Non-monetary Remuneration	15%	7%	4%	2%	12%

<i>By Sectors of the Economy, 1995</i>				
<i>Type of Remuneration</i>	<i>Industry % of Total</i>	<i>Agriculture % of Total</i>	<i>Construction % of Total</i>	<i>Transport % of Total</i>
Wages	69%	80%	78%	72%
Other Monetary Payments (Bonuses, etc.)	16%	10%	12%	11%
Total Monetary Remuneration	85%	90%	90%	83%
Expenditures for Social Development	11%	8%	7%	15%
Expenditures on Social Benefits	4%	2%	3%	2%
Total Non-monetary Remuneration	15%	10%	10%	17%

¹ Enterprises are ranked by size of total outlays from the largest to the smallest.

Source: Special compilation by the Ministry of Statistics, Republic of Belarus

firms spent more than 15 percent of their total outlays for employee remuneration on nonmonetary benefits in 1995, while the quartile of enterprises comprised of the smallest firms spent only 2 percent.

12. While there is often a substantial difference in costs of provision between “social” services provided by enterprises and local governments in the former command economies, such differences in costs are not entirely attributable to differences in the quality of services provided. In fact, municipal cost structures may be lower in part simply because enterprise workers capture substantial rents as compared to their municipal colleagues. Several examples have been found in other CIS countries where municipal wage levels for those providing these services are a third less than those in the enterprise sector.⁸

⁸ ADB Associates found that enterprise kindergarten teachers’ salaries in the Kyrgyz Republic were 10% to 50% higher than those of municipal kindergarten teachers (cited in Freinkman and Starodubrovskaya, “Restructuring of Enterprise Social Assets in Russia,” p.24). Bodnar et al. (p.8) report that municipal service workers (e.g., in housing maintenance) received wages that were 30% to 40% less than those of equivalent employees of Russian coal companies.

13. The proportion of employee remuneration made up of fringe benefits is also shown in Table 3 to be much greater in industry than in agriculture and construction, and greater even in transport than in industry. The apparent reason for the lower spending on fringe benefits in agriculture is greater rural availability of housing and home-grown food. Table 3 shows that enterprise spending on social development, which is largely construction and maintenance of housing and infrastructure, and spending on social benefits, which is in part subsidies for food and meals, account for lower proportions of worker remuneration in agriculture than in other sectors. A possible explanation offered for the importance of fringe benefits in transport is the dominance of large enterprises in this industry as compared to, say, the more atomistic nature of much of the construction industry.

14. Differences in provision of fringe benefits in the 7 oblasts or principal regional subdivisions of Belarus shown in Table 3 may reflect underlying differences in the importance of agriculture and industry in the economies of these regions, but in any event the differences are not great. Separately, it was also found that they were not consistent between 1994 and 1995.

15. Although not reported in Tables 1-3, it was also found that expenditures by enterprises for fringe benefits in 1995 were one third or less of what they were as a proportion of employee compensation in 1994. We have noted that data were not collected for maintenance of housing and infrastructure in 1994 which made up the largest single category of enterprise social expenditures in 1995, accounting in the latter year for 26 percent of the total. Even without this component, however, enterprise "social" expenditures amounted to 35 percent of total employee compensation by firms in 1994. In 1995 by way of contrast, when maintenance expenditures were recorded and could be included in calculations of enterprise "social" expenditures, the latter amounted to 12 percent of total employee compensation.

16. Enterprise spending on construction of houses and infrastructure declined precipitously between 1994 and 1995; this category of spending in 1995 being less than 8% of what it was in 1994. Enterprise construction amounted to 768 billion Belarusian rubels (henceforth BYR) in 1994 and BYR 610 billion in 1995. Taking into account the fact that the producer price index rose more than tenfold from June 1994 to June 1995,⁹ however, enterprise social construction in 1995 amounted to only BYR 61 billion in 1994 prices.

17. The decline in enterprise spending on fringe benefits in 1995 was also evident in our interviews: enterprises that were visited reported reductions in spending for some types of benefits such as summer camps for children, by actively promoting purchases by non-employees and by insisting on greater cost-recovery from users. Many fringe benefits which continued to be offered by enterprises were being treated

Table 3: Composition of Employee Remuneration By Oblast, 1995 (% of Total)

	<i>Brest</i>	<i>Vitebsk</i>	<i>Gomel</i>	<i>Grodno</i>	<i>Minsk City</i>	<i>Minsk Region</i>	<i>Mogilov</i>	<i>Grand Total</i>
Wages	78%	76%	71%	78%	72%	72%	77%	74%
Other Monetary Payments to Employees	11%	11%	17%	12%	16%	13%	12%	14%
Expenditures for Social Development	8%	10%	10%	7%	9%	12%	8%	9%
Social Benefits for Employees	3%	3%	3%	3%	3%	3%	3%	3%
Non-monetary Remuneration	11%	13%	13%	10%	12%	15%	11%	12%

Source: Special compilation by the Ministry of Statistics, Republic of Belarus

⁹ Setting the producer price index for June 1994 to equal 100, the June 1995 value of the index was 1078.

as stand-alone activities which were increasingly expected to pay for themselves.

18. As economic pressures on enterprises increased between 1994 and 1995, it is of interest that enterprises chose to reduce such employee fringe benefits by a greater proportion than direct monetary compensation to employees. Earlier research in Russia found that continued enterprise social provision cushioned the effects of sharp falls in real money wages in the process of transition.¹⁰ Managers interviewed in Belarus, however, regarded many fringe benefits as poorly targeted or low priority forms of benefit which were obvious candidates for reduction or elimination in cost-cutting drives.

19. The overall decline in profitability of enterprises in recent years undoubtedly accounts for the decline in the provision of fringe benefits in Belarus between 1994 and 1995. The economic pressures on enterprises have had effects similar to the institution of hard budget constraints in other former command economies. One would expect the elimination of services of marginal value in these circumstances, and faced with such hard budget constraints, enterprises in other CIS economies have apparently stopped offering some "social" services or even most such services¹¹

20. When the very survival of the enterprise is in question, it is also to be expected that new capital investments will be postponed and even maintenance of existing capital will be deferred if necessary. Similarly, construction of new housing for employees might be expected to cease along with investments in new plant and equipment, and maintenance of housing might suffer along with maintenance of plant and equipment. Such cuts in housing construction and maintenance are well documented in declining industries in other CIS states, such as in the deeply troubled coal industry in Russia.¹²

21. Other economic pressures on enterprises may have been more substantial in Belarus than in many CIS states in recent years, such as those imposed by unfunded mandates of government. In particular, pressures to maintain employment have led to overmanning by an estimated 40 percent, according to submissions to the Supreme Soviet of Belarus. With such pressures to assist in reaching unfunded governmental objectives, it is perhaps surprising that discretionary spending on items such as fringe benefits by Belarus enterprises has not fallen even further.

Comparisons with Provision of Fringe Benefits in OECD Economies

22. The relative size of enterprise spending on fringe benefits in Belarus is not necessarily that different from the practice in some market economies. Whereas fringe benefits amounted to 12 percent of total employee compensation in Belarus in 1995, in the US in the same year nonwage payments voluntarily provided by employers were 10.1 percent of employee compensation.¹³ On the other hand, the range in spending on nonwage benefits in all OECD countries appears to be quite substantial.¹⁴ Practice also

¹⁰ See Commander and Lee with Tolstopiatenko, "Social Benefits and the Russian Industrial Firm," p.i.

¹¹ Freinkman and Starodubrovskaya state that with the imposition of hard budget constraints in The Kyrgyz Republic, "most enterprise non-housing social facilities were simply closed." See "Restructuring of Enterprise Social Assets in Russia," p.8.

¹² Bodnar et al. report that "in the three years preceding housing divestiture, coal associations' actual expenditure on housing decreased almost twofold in real terms due to the deterioration of the mines' financial performance." See "Russia: Financing and Maintenance of Social Assets Divested from the Coal Industry," p.13.

¹³ *Survey of Current Business*, May 1996, Table 1.14, p.10.

¹⁴ By way of contrast, Schaffer cites "costs of social provision" in a 1988 survey of West European industry varying from 1.4% to 12.0% of total labor costs in different countries, but still concludes that "employees in Western firms receive social benefits from their employers which are about as costly in relative terms" as those in transition countries (Schaffer, *Economics of Transition Round Table*, p.248).

appears to vary substantially in the former command economies, with “social spending by enterprises” being 17 percent and 20 percent of the enterprise wage bill in 1993 and 1994 respectively in Russia.¹⁵

23. Such comparisons are of interest because of concerns as to whether voluntary enterprise spending on fringe benefits, together with mandatory wage taxes imposed to raise revenue and to pay for social protection programs are so high that they adversely affect the “competitiveness” of enterprises in the former command economies. Evidence on the comparative burden of wage taxes in Belarus is presented in Appendix A. Wage taxes in Belarus do not appear to pose a problem for competitiveness. If fringe benefits are fungible with wages in Belarus, which is what our research strongly suggests, they are part of the normal functioning of a competitive labor market and also do not adversely affect either the competitiveness of the enterprise nor the economy.

24. The types of spending on fringe benefits in Belarus and in the OECD economies are quite different, however. Whereas firms in Belarus spend primarily on housing, clinics, kindergartens and subsidies in kind, voluntary employer spending on nonwage benefits in the US, for instance, is primarily on pensions and insurance, including health, life, and supplemental unemployment insurance.

25. A further substantial difference is in the methods of provision. Western firms “outsource” provision of these benefits; for instance, by hiring insurance companies to provide them. In Belarus, firms engage directly in a variety of heterogeneous activities which are extraneous to their core business activities in order to provide fringe benefits. It is distinctly curious to see producers of television sets and heavy construction equipment running farms to produce food and vegetables, to mention two examples from our interviews; one suspects that the result is an inefficient diversion of management time from the core activities of the enterprise. This practice of not hiring specialist enterprises to provide these services was attributed to the need to ensure reliable sources of supply in the former command economy. We may expect such vertical integration in production of fringe benefits to decrease as alternative sources of supply become available in the transition to a market economy.

Reasons for Enterprise Spending on Social Assets

26. The reasons for provision of most of these social assets by enterprises provide clues to their appropriate treatment in public policy.

27. Many previous studies have emphasized the importance of non-economic objectives in provision of these fringe benefits. When their opinions have been canvassed, for instance, over half of Russian enterprise managers have cited their social responsibilities as being an important reason for their continued provision of fringe benefits.¹⁶ This study parts company with the emphasis in much of the previous literature not only on the social significance of these fringe benefits but also on the significance of non-economic reasons for their provision.¹⁷ Simple explanations based on the economics of enterprises and economic behavior are quite successful in predicting firm provision of fringe benefits and might be preferred on that basis.

28. A market economist may well wonder why many of these “social” benefits were provided by enterprises and need to be provided by governments. These are not classic “public goods,” in the sense that they are collectively consumed and non-rival in use. There are also few “externalities” attached to much of this expenditure, or advantages that are not captured by households or individuals who benefit directly from

¹⁵ Freinkman and Starodubovskaya, “Restructuring of Enterprise Social Assets in Russia,” p.7.

¹⁶ Commander and Lee with Tolstopiatenko, “Russia: Economic Policy and Economic Restructuring,” p.4.

¹⁷ The studies by Schaffer in the *Economics of Transition Roundtable* and Martinez-Vasquez, “The Challenge of Expenditure-Assignment Reform in Russia,” indicate similar skepticism about the importance of non-economic motives in provision of these fringe benefits.

them. Examples are housing, summer camps for children, spas, sports clubs, vocational schooling and subsidized canteen meals. We should also note that employees are expected to contribute user fees to many of these activities from which they benefit, such as for use of kindergartens, thus explicitly recognizing that these services confer private benefits. We therefore conclude that much of what is called “social” spending by enterprises was merely a convention of socialist enterprise accounting and there is little that is “social” about it. Enterprise spending on such fringe benefits may simply be regarded as part of the wage bargain with employees. An implication is that reductions in spending on many of these fringe benefits merely represent reductions in the real wage level and have no wider social significance.

29. This is not to deny the obvious—that there are social concerns with respect to supply of public goods aspects of services such as kindergartens and public health; that the firm was regarded as an extension of the state in supplying these goods in the former command economy; and that whatever the means of providing these services which will eventually evolve in Belarus, their supply in the period of transition needs attention. With respect to kindergartens, it should also be noted that the final two years of enrollment are in fact the beginning years of schooling, since primary schooling in countries making up the former Soviet Union begins at the age of 7 years.¹⁸ This would argue for public financing of kindergartens by similar means to that used for schooling.

30. If there is little that is “social” about many of these goods and services, however, one might ask why were they provided by enterprises in the first place and why do they continue to be provided by enterprises. A primary reason for their provision by enterprises was that wages were centrally fixed in the former command economy and such controls have continued into the period of transition. Until 1995, for example, enterprises in Belarus were subject to global caps on the wage bill which, if exceeded, led to tax penalties. But enterprises could compete for labor by the provision of fringe benefits and such competition was a rational economic response to the general scarcity of labor in the old command economy.¹⁹ Such motivations were evident in enterprise provision of benefits such as kindergartens.²⁰ It was especially important, however, for enterprises to compete for labor by providing housing, which was the largest form of in-kind payment.²¹ Some other subsidies in kind, such as for transportation, also originated in this need to supply housing. Thus commuting subsidies were offered in an effort to offset the effects of tight local housing markets by drawing in labor from wider areas.

31. We inferred above that the breakdown of worker pay between money wages and fringe benefits should ordinarily be of no interest to public policy, if there is no bias in public treatment of the two types of remuneration. In these circumstances, the composition of remuneration is strictly a matter between employer and employee. In fact, however, public policy does not provide a level playing field in treatment

¹⁸ Klugman et. al. observe that “kindergartens did indeed have a developmental role in the Soviet Union and primary school curricula assumed that children already had basic literacy and counting skills.” See “Enterprise Divestiture of Kindergartens and Childcare Arrangements in Central Asia,” p.3.

¹⁹ Interestingly enough, provision of important fringe benefits such as employer-provided health insurance has similar origins in the United States. “Employer provided health insurance was encouraged by the 1942 Stabilization Act, which placed limits on wage increases but allowed employers to offer insurance plans to their employees,” (Jonathan Gruber and James Poterba, “Tax Subsidies to Employer-Provided Health Insurance,” *NBER Working Papers* No. 5147, June 1995, p.5 fn. 3).

²⁰ “.enterprise provision of kindergartens ...furthered state policy of attaching employees to their place of work to discourage unplanned turnover. Enterprise managers were willing agents in this respect, as they had little autonomy in setting money wages, and used noncash benefits, such as subsidized kindergartens, to attract and retain workers.” Klugman et al., “Enterprise Divestiture of Kindergartens and Childcare Arrangements in Central Asia,” p.3.

²¹ “In all socialist countries, enterprise housing production programs were a key means of gaining access to new housing...enterprises which produced significant amounts of housing were seen as attractive employers. Employment with such firms provided a way to jump the waiting list for housing provided by the state.” Buckley and Gorenko, “Unwinding the Socialist Wage Package: The Role of Housing in Russia,” p 1.

of fringe benefits and wages in Belarus. Whatever the historical origin of enterprise provision of nonmonetary benefits, their continued provision appears to owe much to their tax treatment.

32. Strategic objectives in all tax systems involve balancing goals of raising revenue, equitable treatment of individuals, efficiency in the allocation of resources and incentives for the supply of particular goods and services. With respect to equity, a fundamental principle underlying an income tax is that all income from whatever source should be taxed similarly.²² Efficiency concerns dictate similar equality in treatment of different sources of income, so that resources are not wasted in avoidance activities to minimize tax liability or enforcement efforts to counter such avoidance.²³ It is not unusual, however, to find some types of fringe benefits receiving preferential tax treatment to encourage their provision. In the United States, for instance, employer-provided health insurance premiums are deductible business expenses in the calculation of corporate income taxes, are not taxable as personal income in the hands of the beneficiary and are not included in the wage tax base for the payroll tax.

33. There is, in fact, a close interaction between the sizes of tax rates on income and the extent to which nontaxable benefits are offered to employees. Recent econometric evidence suggests that lowering income tax rates substantially reduces the demand for nontaxable benefits in the US.²⁴

34. Belarus is no exception to this relationship between tax rates and the extent to which nontaxable benefits are extended to employees. With one exception, all fringe benefits in Belarus are deductible before enterprise profit taxes are calculated.²⁵ All non-wage fringe benefits are excluded from the payroll tax base, however, and such taxes amount to 46 percent of payrolls. On the side of personal income taxation, moreover, the principal nonmonetary form of income, that from housing services which have been substantially provided by employers, is tax-free to the recipient—whether such housing is actually built by employers or acquired by means of monetary subsidies from employers. Other types of financial and non-financial benefits for workers receive less favorable but still advantageous tax treatment. They are theoretically subject to tax if they exceed 30 and 20 minimum monthly wages, respectively, or just under 3 and 2 months salary for the average worker.²⁶ Enforcement of the latter provision appears to be ineffective, however.²⁷ In total, this tax treatment constitutes a powerful incentive to both employers and employees to substitute nontaxable benefits for wages.

35. Not unnaturally, both state-owned enterprises and firms in the newly emerging private sector respond to these incentives in the tax system to supply nontaxable benefits to employees. Newly emerging

²² The underlying principle is that of *horizontal equity*, meaning that likes should be treated alike.

²³ The significant costs of such anti-avoidance activity are illustrated by the estimate that as much as one-half of the US Tax Code before 1986 (the year of substantial tax reform) was devoted to limiting the extent to which taxpayers could take advantage of the lower tax rate applied to income in the form of long-term capital gains. See Charles E. McLure, Jr., cited in Economic Council Of Canada, *The Taxation of Savings and Investment*, (Ottawa, Ont.: Minister of Supply and Services, 1987), p.9.

²⁴ Stephen A. Woodbury and Daniel S. Hamermesh find that "...wages and [nontaxable] benefits are highly substitutable and that the demand for benefits is price elastic. Changes in income taxes induce a change in the relative price of benefits and wages that in these samples generates substantial substitution between wages and nonwage compensation." Their estimates suggest that cuts in average marginal tax rates of 3-6% in the mid-1980's in the US reduced the share of nontaxable benefits in total compensation by one-half percentage point (from a hypothetical 19% to 18.5%). "Taxes, Fringe Benefits and Faculty," *The Review of Economics and Statistics*, Vol. LXXIV, May 1992, No. 2, pp. 294-295.

²⁵ The exception is that grants or loans to employees for housing are only exempt up to 10% of after-tax profit of enterprises.

²⁶ In June 1996, the minimum monthly wage was equal to BYR 100,000. The average salary in March 1996 was BYR 1,066,600.

²⁷ Khankevich, in "The Taxation System in the Republic of Belarus," (p.18) comments that "even though legislation says that income tax should be paid on any form of income, in this case it is possible to calculate the tax amount but not actually collect it."

enterprises also build housing for their employees, for instance. Some of the new private enterprises are able to exploit possibilities for tax avoidance in non-taxation of certain types of income in ways that may be difficult for state-owned enterprises to emulate, however.²⁸

36. It has been reported elsewhere that workers in some transition countries have opted for preservation of these nonmonetary benefits instead of receiving wage hikes; the bias in tax treatment described above may suffice to explain why. Great care has to be taken in giving tax incentives for some of these services, however, with housing being a pertinent example. Most citizens of Belarus pay nothing for rent in the sense of paying for the capital costs of housing, since the latter has been provided by enterprises or the state. The term that is frequently translated as rent—in Russian *oplata za zhil'e*—is simply a payment for routine operation (including all utility charges) and maintenance. This explains in large part why families in Belarus spend so little on housing in comparison to families in OECD countries. Rent and utilities accounted for only 4.4 percent of family expenditures in Belarus in 1995; less, it might be noted, than the share of family budgets spent on clothing (6.3 percent) or even alcohol and tobacco (4.9 percent).²⁹ By way of contrast, the median share of consumer expenditures on housing and utilities in 23 OECD countries recently surveyed was 19 percent (in Switzerland).³⁰ The virtual exemption of such a large sector of the economy from the tax base in Belarus requires that tax rates be raised substantially on remaining activities to obtain given revenue goals and supplies a potent incentive to seek preferential tax treatment for other “worthy” activities. It might be objected, of course, that owner-occupied housing in many OECD economies is also known for receiving preferential tax treatment taking such forms as exemption of returns and the deductibility of debt-finance from income taxation. Recent research challenges the conventional wisdom that owner equity in housing is a lightly taxed asset in OECD countries, however.³¹

37. It is of interest that the Russian Government has recently acted to make fringe benefits taxable in calculation of the payroll tax base for social insurance programs. A decree issued in January 1996 expanded the payroll tax base in Russia to include non-wage worker compensation in the form of fringe benefits and payments in kind. The Government of Belarus might well consider following the example of the Russian Government in broadening the base subject to payroll taxation. The incentive to substitute nontaxable fringe benefits for money wages is even higher in Belarus than in Russia as a result of payroll tax burdens to finance social insurance and related programs. Such payroll taxes amount to 46 percent of wages in Belarus, as opposed to the 39 percent level applying in Russia.

38. While pressure to provide “tax expenditures,” or favored tax treatment for particular activities exists in all economies, there are methods of controlling such pressure. “Base broadening” by elimination of tax incentives permits revenue goals to be obtained with lower overall tax rates, and has become synonymous with “tax reform” in many OECD economies in recent years. We saw above that reduction in overall tax rates leads to a reduction in demands for nontaxable fringe benefits. More selective incentives can also be substituted for blanket exemptions. An example might be to eliminate tax deductibility for enterprise expenditure on kindergartens but allow daycare expenditures to be deductible from personal income taxes paid by employees. Individuals might also be required to declare an extensive list of fringe

²⁸ Because interest income is untaxed, for instance, it has been common practice for banks to pay their employees in part in interest income on deposits the banks contribute to accounts their employees hold with them.

²⁹ *Expenditures and Income of the Population in Belarus: 1995*, Table II.1. Ministry of Statistics and Analysis, Republic of Belarus, Minsk 1996.

³⁰ Charles Yuji Horioka, “Japan’s Consumption and Saving in International Perspective,” in *Economic Development and Cultural Change*, vol. 42, no. 2, Jan., 1994, Table 4, p.304.

³¹ “...it is striking that, contrary to popular belief, these rates [effective tax rates for house purchase financed by equity] taking into account all relevant taxes are *not* generally low compared to other assets, particularly in the case of zero inflation.” OECD, *Taxation and Household Saving*, (Paris: OECD, 1994), p. 110.

benefits as taxable income—Canada, for instance, goes so far as to declare frequent flyer points as taxable income for recipients! Alternatively, enterprises may not be permitted to reduce their tax liability by providing some fringe benefits. Australia is one country which has recently tightened up on such corporate tax deductibility for fringe benefits.

39. We hasten to add that none of these policy options is intended simply to increase overall tax revenues. The primary objective of these base-broadening exercises is to share a given tax burden more equitably and efficiently over all sources of income.

Priority Problem Areas: Utilities, Housing and Crèches/Kindergartens

40. Governmental attention in Belarus is currently focused on the problems of enterprise divestiture of utilities, housing and crèches/kindergartens.

41. The concern with utilities simply reflects an interest in ensuring continuity of supply where enterprises are failing or are reluctant to continue supplying community services because of arrears in payment. Problems with cost recovery for utilities in Belarus appear to have been disproportionately those of recovering such costs from households. According to a letter from the former Minister of Industry to the Council of Ministers in December 1995, arrears for heat supplied to residential areas in December 1995 amounted to over 34 billion rubels but were not consequential for enterprises, government departments or other “budgetary” organizations.³²

42. As we saw above, the final two years of kindergarten in Belarus are the beginning years of schooling, since primary schooling in the countries comprising the former Soviet Union begins at the age of 7 years. This would argue for financing of at these final years of kindergarten by means similar to those used for schooling. Further, expenditures on kindergartens in part represent spending on “custodial” care such as daycare or crèches. Although kindergarten enrollment has fallen with declining birthrates, its use for custodial purposes has increased as a share of total enrollment. Owing to recent economic difficulties, more mothers appear to have chosen early return to the labor force after childbirth.³³ Finally, kindergartens are part and parcel of the problem of enterprise divestiture of housing. When enterprises created housing estates, kindergartens were included in the yards of the apartment blocks and so were a joint cost with housing.

43. Enterprise divestiture of housing remains clearly the most substantial adjustment to be made in the system in view of its importance to consumer budgets, and an understanding of the issues involved requires an understanding of how housing was formerly provided and financed and what changes have recently taken place in this respect. We should note that privatization of housing is proceeding in Belarus, but this does not affect the analysis. Nor are the problems associated with divestiture of housing restricted to enterprises.³⁴

44. We should note first that housing is a liability and not an asset of enterprises. Indeed, it is somewhat of a misnomer to speak of enterprises “divesting” themselves of this “asset.” Housing never was an asset that was available for disposition by the enterprises which built it. Once housing had been allocated to all but contract employees, it was at the disposition of the employee. The occupants could not

³² Letter to the Cabinet of Ministers from Minister V.I. Kurenkov, December 15, 1995.

³³ Minsk City officials informed us that of 90,000 children in 500 kindergartens they were operating, some 10,000 were less than 3 years old. Such crèches were only introduced at the beginning of 1994, when the economic situation worsened. Previously, mothers stayed on paid maternity leave until children were three years old.

³⁴ Disposition of employer constructed housing has also been a problem for government departments (other budgetary organizations, in the nomenclature employed in Belarus). Much housing formerly owned by the Ministry of Defense, for example, was turned over to local authorities in Minsk in 1994/1995.

be evicted by the enterprise because they changed employers and they could hold this housing after they retired from the enterprise. They could even swap apartments with other families. Contract workers were the exception, but even they had the same rights to dispose of housing if they lived in it for 10 years.

45. Whereas the connection between enterprise-provided housing and employment in an enterprise became increasingly remote with the passage of time, enterprises were still left with the burden of maintaining the apartments they constructed; a burden they wanted someone else to assume. Interestingly enough, the process of enterprises ridding themselves of their housing responsibilities started before transition: enterprise housing was being transferred to local executive councils in the early 1980's.

46. The view set out above that enterprise-produced housing is not considered to be an asset of the enterprise is supported by Russian practice in privatization. There, enterprises to be privatized are not allowed to include housing, utility networks supporting housing located outside enterprise property, or maintenance activities for these activities in their charter capital.³⁵

47. Housing nevertheless remains critical to efficient allocation of resources and growth. It has been estimated, for example, that a quarter of all unemployment in 1992 in Poland was due to limitations on labor mobility caused by lack of housing.³⁶ Public policy therefore should be concerned with continuity in the supply of housing in the transition to a market economy.

Future Governmental Responsibility for and Financing of Divested Services

Divested Services: Whose Responsibility?

48. Which level of government should assume responsibility for those social functions being divested by enterprises that might continue to be supported by the state? The assumption in most of the literature on enterprise divestiture of "social" assets in the former Soviet Union is that government provision of these services should be undertaken by local governments. The question as to whether this is the appropriate level of government to undertake these functions is seldom if ever raised, and needs to be examined more closely. It is obviously appropriate for local governments to be responsible for local infrastructure such as roads, district heating and water and sewer reticulation. Many of the benefits from these functions are strictly local in effect.

49. Responsibilities for other social services appear to have been assigned to different levels of government in the past on the basis of complexity of the services involved. Thus local governments have been responsible for basic education in the primary schools and for local health clinics, while higher and more specialized levels of education and medical care were responsibilities of the national government. In view of their previous responsibilities, local governments may be the logical level of government in the transition economies to undertake some social functions being divested by enterprises. For example, kindergartens would seem to be a logical responsibility for local governments, given that they are now responsible for primary school education.

50. While this is a point of view that is not common, however, there are legitimate questions as to whether "people" services such as health or education are appropriate local responsibilities. It is not apparent, for instance, that externalities in health or education which lead to government intervention in provision of these services are primarily local in nature.

³⁵ See Mari Kuraishi and Lev Freinkman, "Russia: Enterprise Restructuring and Social Asset Divestiture," Notes for World Bank/IMF/EBRD Meeting, May 31, 1995, p.5; Freinkman and Starodubrovskaya, "Restructuring of Enterprise Social Assets in Russia," p.9.

³⁶ Fabrizio Coricelli, Krysztof Hagemeyer and Krysztof Rybinski, "Poland," in Simon Commander and Fabrizio Coricelli (eds), *Unemployment, Restructuring, and the Labor Market in Eastern Europe and Russia*, EDI Development Studies, Washington, DC., The World Bank, 1995, p. 74.

51. The suitability of services for decentralized provision may also differ among CIS states. The amount of decentralization appropriate for Russia with its 11 time zones, numerous ethnic groups and population of 150 million, for instance, may not be appropriate for Belarus with its more compact area and homogeneous ethnic composition, and population of only 10 million. The period of transition may provide an opportunity for Belarus to reconsider the assignment of responsibilities between levels of government. One smaller CIS state, Armenia, has, in fact, reassigned responsibilities for education to the center.

52. Whatever level of government is assigned responsibility for these social services being divested by enterprises, the means of financing assigned for the purpose need to be adequate to perform the function. In this respect, some observers have viewed the actual process of assigning "divested social functions" to subnational governments as a form of buckpassing by central governments, in that the responsibilities have been transferred without assignment of adequate revenue sources.³⁷

53. Another problem with the question of what level of government should be responsible for these functions in Belarus is that neither the allocation of functions between levels of government nor the financing of regional (oblast) and district (rayon) governments suggests that there really are fully autonomous local governments in Belarus. Meaningful local government requires some autonomy in its functions and financing. Although local and regional executive council members are elected in Belarus, these subnational levels of government are, in other respects, simply lower level branch offices of the central or republican level of government. They raise little revenue themselves and often appear to function as mere agents for the delivery of services such as health and education; the parameters of providing such services are set by the central government. In these regards, Belarus is typical of many countries in transition.

Responsibility for vs. Delivery of Divested Services

54. We should note that it is the responsibility for functions that is in question here, and not their actual provision. Actual delivery of these functions can be accomplished by a number of alternative organizations, including private contractors, non-government organizations and even other levels of government under contract. Citizens of Belarus might be surprised by some of these alternatives; for example, fire services are provided entirely by voluntary organizations in Chile, and municipal and provincial police services are often provided by means of contracts with the federal police force in Canada. Nor is enterprise provision of these services simply a matter of replacing state-owned enterprises with private enterprises; as has been repeatedly shown, it is the presence of competition and not simply state ownership that leads to efficient provision of these services.³⁸

Local Government Finance: Problems and Possible Solutions

55. If some of these "social" functions are to be divested by firms but continue as a governmental responsibility, it follows that they have to be acceptably financed. Existing sources of financing may not be satisfactory for this purpose. Alternative sources of finance include increased cost recovery from users.

³⁷ See for instance Jorge Martinez-Vasquez, "The challenge of expenditure-assignment reform in Russia," *Journal of Environment and Planning*, 1994, Vol 12, pp. 277-292; Christine I. Wallich, "Russia's Dilemma," in *Russia and the Challenge of Fiscal Federalism*, a World Bank Regional and Sectoral Study, ed. Christine I. Wallich, 1994, pp. 38-43.

³⁸ According to one examination specific to the efficient supply of local government services, "most of the efficiency gains from contracting out have resulted from an increased scope for competition rather than from the fact that the service was provided by a private contractor." Harry Kitchen, *Efficient Delivery of Local Government Services*, Discussion paper No. 93-15. School of Policy Studies, Queen's University, Kingston, Ont., Canada, 1993, p.22.

In the context of Belarus, we note that Presidential Ukase No 351 of 4 September 1995 simply *orders* the reduction of housing maintenance expenditures by 10-20% by the introduction of "contracts." These contracts do not reduce housing maintenance costs by encouraging competitive provision of communal services.

Where this is not appropriate, financing could be sought from the local or the central governments. If local governments are to be used as agents of the central government in delivering services, appropriate means of transfers have to be devised for this purpose. Partial or bridge financing by enterprises might also be requested to ease the problems of divestiture.

Sources of Local Government Finance and Trends Over Time

56. Table 4 indicates the sources of budget revenues for subnational governments and their changes over recent years. As will be described below, some subnational functions are also financed by extrabudgetary funds. Table 4 reveals what appears to be a striking increase in centralization of government in Belarus in recent years: in the period from 1992 to 1996, the share of total budget revenues allocated to subnational governments decreased from 70 percent to 48 percent. The primary sources of local government revenues are shown to be revenue sharing with the central government and direct subsidies from the central government. The share of explicit central government subsidies in local budget revenues has been growing rapidly in importance, from 1.4 percent in 1992 to 24 percent in 1996.

57. Table 4 also confirms that there is little independent local government financing in Belarus—as such financing is known in other countries. As a proportion of local government revenues in Belarus, Table 4 shows that local taxes accounted for the puny share of only 0.6 percent in 1995 and are projected to account for only 0.4 percent in 1996.

58. The so-called local taxes that regional and district governments are permitted to levy are for the most part minor “service” fees such as license fees for dogs or parking charges, although local governments do have the right to levy “sin” taxes on tobacco and alcohol. With the exception of the sin taxes, these taxes which have been assigned to local governments are not real revenue raising instruments.

59. Local governments were originally given wider scope to impose local taxes: Khankevich (p.19) observes that “when the existing taxation system was introduced local authorities were granted the right to impose within their jurisdictions local taxes, duties and levies without legislative restrictions as to their number, composition and maximum amount.” This experiment led to complaints by enterprises about tax-grabs by local authorities. As a result, the taxes that local governments could impose on enterprises were restricted in 1993 and a ceiling was imposed on their total burden. They are not allowed to exceed more than 5 percent of a firm’s disposable profit or 3 percent of its added value.

Table 4: Sources of Subnational Government Revenues and Share of Subnational Government Revenues in the Central Government Budget

	1992 (%)	1993 (%)	1994 (%)	1995 (%)	1996 (%)
Total subnational revenues	100.0	100.0	100.0	100.0	100.0
•National taxes entirely allocated to subnational governments	52.7	43.4	50.5	52.5	31.0
•National taxes shared with central government	45.9	53.9	46.6	24.3	44.4
•Central government subsidies	1.4	2.7	2.9	22.6	24.2
•Local taxes and duties				0.6	0.4
Share of local revenues in budget of the central government	70	60	56	55	48

Source: Khankevich, “The Taxation System in the Republic of Belarus,” p.41

60. The central government acted correctly in restricting the ability of local governments to impose some types of taxes. For efficiency reasons, most tax policy specialists support restrictions on the ability of local governments to impose corporate taxes, for instance, so that local governments cannot “export” the burden of their actions to non-residents.

Weaknesses of Revenue Sharing: Rural Local Governments and Stability of Transfers

61. As Table 4 indicates, revenue sharing is the principal method of financing subnational governments in Belarus by budgetary revenues. Table 5 indicates 1996 sharing arrangements for each major tax. Revenue sharing is intended to be a form of untied transfer payment, in which the central government shares some of the taxes it collects with local governments according to the “derivation” principle, or the area of origin (or collection) of central government taxes. In revenue sharing arrangements, local governments have no control over the base and rate structure of the tax and are not responsible to taxpayers for funds obtained. A serious problem with revenue sharing based on the derivation principle is that it yields more resources to the wealthier regions and makes interregional income imbalances worse. This reflects patterns of production and the fact that most taxation in Belarus is based on the source or location of production, rather than the residence of the taxpayer or the destination of goods taxed.³⁹ Revenue sharing arrangements accordingly reflect these concentrations in the location of output in Belarus.

62. We can illustrate this generic defect of revenue sharing by examining the case of agriculture and by extension agricultural districts in Belarus. Because it regards agriculture as a particularly troubled sector, the Government of Belarus has made significant efforts to lower this sector’s tax burden. As a result, while the share of GDP arising from agriculture was 11 percent in 1995, the sector accounted for only 5 percent of total tax and extrabudgetary fund revenues.⁴⁰ Ironically, such favorable tax treatment for agricultural producers penalizes subnational governments in agricultural areas, because 75 percent of subnational government revenues are derived from revenue sharing on the basis of taxes collected within the subnational jurisdictions.

63. Revenue sharing in Belarus has another shortcoming. The distribution of revenue sharing is decided annually in Belarus by means of the State Budget Law. It would obviously be desirable for subnational governments to have more stability in their revenues for planning purposes. Transfer arrangements for longer periods of time exist in market economies. In Canada, for instance, federal-provincial transfer arrangements are renewed by federal legislation every 5 years, and changes within the period require notification and in some instances compensation.

³⁹ Personal income taxes, as well as wage taxes to finance social insurance programs, are deducted by the employer at source in Belarus, whereas the personal income tax is often based on rules applying where people live (rather than where they work) in OECD countries. Profit taxes are similarly collected on the basis of where corporate headquarters are located in Belarus, and property taxes are naturally origin-based taxes. Under GATT rules, the destination principle is normally applied in taxation of goods traded internationally, so that tax rates are determined by the jurisdiction in which the goods are purchased. In the case of Belarus, the VAT is based on the source of production although there is a lack of coherence in the principles applied to taxing international trade. As a result, most Belarus taxation is source or origin based, as opposed to residence or destination based, and tax-sharing arrangements reflect concentration in the location of production by region and hence produce disparities in regional revenues.

⁴⁰ See Khankevich, “The Taxation System in the Republic of Belarus,” p. 16. By way of contrast, industry accounted for 26% of GDP and 47% of tax and extrabudgetary fund revenues.

Extrabudgetary Funds

64. We noted above that subnational governments have received a rapidly decreasing share over time of budget revenues in Belarus. Belarus has, however, made increasing use of the device of “earmarked” or “extrabudgetary” funds to finance critical governmental needs. While all taxes and contributions were equal to 50 percent of GDP in 1995, extrabudgetary funds amounted to 19 percent of GDP, or 38 percent of all taxes and contributions. Even more extraordinary, such earmarked funds are scheduled to increase to 56 percent of government receipts in 1996, so that more government revenues will accrue from off-budget than from on-budget sources!⁴¹

65. This extrabudgetary financing method has been adopted to support operating and maintenance costs of kindergartens and housing, which as we have seen are two of the principal “social assets” of enterprises that are increasingly being divested to local governments. Two extrabudgetary funds were instituted in May 1992 and December 1993 for kindergartens and housing respectively. In the case of

housing, 0.5 percent of enterprise revenues have to be devoted to maintenance of housing. If not spent directly by the enterprise, payment of an equivalent amount of enterprise revenues has to be made to the local executive councils for support of housing. The burden of this levy on the turnover of enterprises is substantial. Further, the required rate of earmarking revenue is arbitrary and has little to do with the costs of maintaining housing—complaints about the burden of this earmarked tax led to its rate being reduced from 1 percent of enterprise revenues in 1995 to 0.5 percent for 1996.

66. Funding for the operations and maintenance costs of local kindergartens is also promoted by an extrabudgetary fund, but one levied on after-tax profits. Local executive councils are permitted to raise this levy at a rate varying from 1 percent to 5 percent of the after-tax profits of enterprises. (Minsk City levies a 5 percent tax). Again, the tax is only collected if enterprises do not spend the specified amount directly on their own kindergartens. This source of financing obviously varies with the profitability of firms.

67. It is widely acknowledged that the use of extrabudgetary funds, or the “earmarking” of revenues for specified purposes, should be restricted to those instances where there is a strong benefit connection

Table 5: 1996 Revenue Sharing in Belarus
Share of National Taxes Allocated to Central and Subnational Budgets

Tax	Central Government Budget (%)	Local Budget (%)
VAT	50	50
Profit tax	60	40
Excise	70	30
Personal Income Tax		100
Real Estate Tax		
• Central government property	100	
• Subnational Government Property		100
Severance Tax		100
Tax on Potassium and Rock Salt Extraction	50	50
Land Tax		
• Within cities	40	60
• Outside cities	25	75
Chernobyl Tax	100	
State Duty	100	
Timber Tax		100
Fire Team Maintenance Duty	100	
Duty on the right to use public roads	100	

Source: Khankevich, “The Taxation System in the Republic of Belarus,” p.39

⁴¹ All data in this paragraph are taken from Khankevich, “The Taxation System in the Republic of Belarus,” p.11.

between the expenditure financed and the revenue raised—that is, when the latter is basically a user charge for the former. Conversely, earmarking of funds is inappropriate where there is no such benefit rationale; where the activities concerned redistribute income, for example. All other prospective public programs where there is no benefit rationale should receive general fund financing and should compete on the same terms for these limited public funds within a common budgetary framework. It is therefore cause for concern that 56 percent of all government receipts in Belarus are currently flowing into extrabudgetary funds. By these standards, too, housing maintenance and kindergartens are not appropriately financed as benefit taxes by the extrabudgetary funds levied on enterprises in Belarus. The financing of these major fringe benefits is redistributional. In the case of both housing and kindergartens, enterprises are footing the bill for activities which benefit only subsets of their employees and which also benefit many non-employees. As we have seen, for instance, those now living in housing built and maintained by enterprises often have no past or present connection with the enterprise.

Potential Sources of Finance

User Cost Recovery

68. Appropriate financing for local utilities requires full cost recovery from users. Low levels of cost recovery for housing and utilities were a matter of deliberate redistributional policy in the Soviet Union, and low-priced energy helped to make this policy possible. This policy proved difficult for the authorities in Belarus to change. As late as 1994, the cost recovery rate for all housing maintenance and utilities was only about 10 percent and was as low as 4 percent for heating and 2 percent for housing maintenance and water. The cost recovery rate for electricity was significantly higher than for most utilities, but was still only 25 percent.

69. These cost recovery rates were unsustainable once Belarus no longer had access to low-priced energy. In 1995, the government pursued a policy of increasing housing and utility cost recovery ratios with determination. As a result, household cost recovery ratios were raised to 50 percent for household maintenance, 65 percent for heating, 54 percent for water and 84 percent for electricity.

70. An important step towards increasing user cost recovery for household utility services is to meter individual apartment usage, since this enables the household to control its own usage. In the former Soviet Union, electricity usage was the only household utility which was individually metered—which may also account for the fact that it had the highest cost recovery rate. Belarus has taken an important step towards increasing user cost recovery for other utilities with a government initiative to encourage additional metering for household water supply.⁴² Metering of water supply to households has yet to be adopted in many other member states of the former Soviet Union. Unfortunately, it would seem to be impractical to meter individual household usage of heat in many of Belarus' Soviet era apartment buildings. Installation of individual metering for apartments would necessitate complete replacement of the plumbing systems in these buildings.

71. It is enigmatic to an outsider that property owners and residents in Belarus actually continue to receive subsidies for housing maintenance, particularly where housing is being privatized. The principle that is applied is that if one type of housing occupant gets a subsidy, all housing occupants benefit from the same subsidy regardless of whether the housing is enterprise, state or privately owned. Housing maintenance services are an obvious case where user cost recovery principles should be applied—the

⁴² The program was launched on 7 June 1994 by a decree of the Cabinet of Ministers, and consists of metering for both individual apartments and apartment blocks. Although apartment meter installation was subsidized by 75% in 1995 and by 50% in 1996, the subsidy is scheduled to be reduced to 25%.

resident of Grodno should not be expected to pay for maintenance of housing which has been privatized in Minsk, for instance.

72. Objections to user cost recovery for housing and utilities often rest on assumptions that users in transition economies will not be able to afford the price levels entailed, given their current reduced incomes. Such arguments ignore the fact that shortfalls in cost recovery are now being paid for somehow—by taxpayers, including those who do not use these utilities, or by “inflation taxes” arising from printing money to finance government deficits. Cost recovery from users leads to savings which can be applied to reduce these taxes or government deficits.

73. It is, in fact, counterproductive to subsidize aggregate utility use for distributional reasons—better-off people benefit more from such subsidies since consumption normally rises with income.⁴³ Belarus appears to be no exception to this rule. The 1995 Household Budget Survey shows that average monthly spending on rent and utilities rose from 57,000 rubels per family member in the lowest quintile of the income distribution to 67,000 rubels in the highest income quintile.⁴⁴ The Government of Belarus is attempting to deal with income distributional problems arising in payment for housing and utilities in a more appropriate manner than by subsidizing all users. As described in the World Bank’s recent Poverty Assessment for Belarus, low-income households receive housing allowances if payments exceed 15 percent of household income.⁴⁵ This approach targets assistance to families in greater need and would also seem to be appropriate for dealing with distributional considerations which arise in provision of services other than housing and utilities, such as daycare.

Property and Real Estate Taxes

74. Property and real estate taxes are appropriate means for financing municipal services to property, such as street lighting and road maintenance. Indeed, Appendix B indicates that property taxes are the principal form of autonomous finance of local governments in OECD countries. Keen (p. 4) notes that property taxes accounted for 5.5 percent of all OECD governmental revenues in 1992 and only 2.7 percent of total revenues in Belarus in 1995, or less than half of their comparative importance in OECD countries. Belarus needs a more useful form of property or real estate tax than the present land use tax, however, which in 1995 cost more to collect than it raised in revenue!⁴⁶ Fortunately, reform of this tax is being considered by the Task Forces examining tax reform in Belarus in 1996.

Appropriate Forms of Central Transfers to Local Governments in Belarus

75. It is clear that local governments will not be able to finance municipal services from their own revenues until appropriate tax instruments such as a reformed property tax are put in place. Indeed, there will always be a case for transfers to enable poorer local governments to provide critical services in a manner similar to that in better-off localities. To achieve this objective, some systematic form of “equalization” of local revenues is needed in Belarus. (The argument for such transfers is separate from that for personal transfers such as low-income supplements or unemployment insurance). While the central government of Belarus recognizes this need, it deals with it currently in ad hoc ways—by subsidies which differ by locality and by changing the local share in revenues assigned to oblasts. For instance, the share of lower-income oblasts in VAT revenue is higher than that permitted to the city of Minsk (which has the

⁴³ For an explanation and graphical illustrations of this point, see the *World Development Report, 1994* (Washington, DC, The World Bank, 1994), p 81.

⁴⁴ *Expenditures and Income of the Population in Belarus: 1995*, Table II.2E. Ministry of Statistics and Analysis, Republic of Belarus, Minsk 1996.

⁴⁵ Paolo Roberti et al., *Belarus: An Assessment of Poverty and Prospects for Improved Living Standards*. World Bank (EC4C1), June 1996.

⁴⁶ The conventional definition of a “nuisance tax” is that it costs more to levy than it raises in revenue.

status of an oblast). These local revenue shares have been changed several times in an attempt to benefit low-income regions.

76. The most thoughtful approaches to these intergovernmental transfers involve formula financing for transfers from central to local governments, where the criteria for the transfer is determined in advance by legislation. Formula financing of transfers to local government makes possible greater stability, certainty and openness in these payments. Because this formula financing is systematic and open, it avoids implications that some kind of political slush fund is involved and reduces the interminable bargaining that was (and continues to be) a feature of interregional distribution in the former Soviet Union and many of its successor states.

77. Equalization schemes in many countries compensate for differences in local revenue-raising capacity, and sometimes also for local cost differences in supplying services.⁴⁷ Such equalization payments are unconditional with respect to uses of the funds.

78. “Conditional” grants are also used if higher levels of government wish to ensure that local governments supply specific services (an example might be to encourage the teaching of the Belarusian language in schools) or to ensure that specific levels of service are provided (usually minimum levels of service). Such grants give general guidance to local governments providing the service with respect to the objectives of the donor government but do not lead to the latter micro-managing the service.⁴⁸

79. The Government of Belarus should consider adoption of such formula financing. Since officials in the Ministries of Economy and Finance are interested both in formula approaches to equalization and in conditional grants from the republican to subnational governments, the World Bank might well consider arranging courses for officials in Belarus on such approaches to intergovernmental financing.

Continued Partial Financing or Bridge Financing of Services by Enterprises

80. Some incentives already exist for enterprises to share the burden in transferring assets to local governments. Thus local executive councils have the right not to accept housing or kindergartens enterprises wish to divest, if the latter are not in “satisfactory” condition. While it is presumed that local governments would be obliged to accept most of these assets if an enterprise failed, some kindergartens are known to have been closed by enterprises rather than turned over to local governments.

81. Perhaps more use might be made of continued enterprise contributions to aid divestiture. An example might be drawn from the case of educational institutions where human capital is being created which is to some extent specific to the enterprise. One large enterprise interviewed in Minsk, for instance, had just divested a trade school to the local authorities but will continue to hire many of the graduates. The local authorities would seem to have a good case for asking for some continued support from the enterprise for such schooling.

Conclusion

82. In Belarus as in other former command economies, divestiture of “social assets” is seen as a necessary process in the transformation of enterprises so that they can function appropriately in a market

⁴⁷ Equalization schemes based on fiscal capacity usually calculate the per capita revenue-raising capacity of all taxes in different regions and redistribute revenues to achieve some target of relative per capita fiscal capacity in all regions. Such programs may consist of *direct* redistribution between regions, as in Germany, Switzerland and Denmark or *indirect* redistribution as in Canada, where equalization schemes for provincial revenues are a constitutional responsibility of the federal government.

⁴⁸ Conditional grants have also been recommended for use in Russia. For a more detailed description of this type of transfer, see Annex 4, “Conditional Grants: International Experience” in World Bank Country Study, *Fiscal Management in the Russian Federation*, 1996, pp.141-145.

economy. An important public policy problem in transition economies is widely considered to be that of maintaining supply of these services after enterprise divestiture.

83. The present study finds that the term “social assets” is a misnomer for just about all enterprise activities described under this heading in Belarus, most of which are simply fringe benefits that are part of the wage bargain with the employee. Provision of these fringe benefits was a rational response by enterprises to shortages of labor and constraints on wage offers in the old command economy and firms in market economies have responded similarly to such economic incentives to provide fringe benefits. The favorable tax treatment of fringe benefits explains much of their continued importance, both in Belarus and elsewhere.

84. These fringe benefits were cut by at least two-thirds as a proportion of employee remuneration between 1994 and 1995 in Belarus. The economic downturn in this period contributed to the relative decline in payment of these benefits, particularly those involving capital expenditures such as housing construction and maintenance. The relative decline in fringe benefit payments may not have been so great had enterprises not been required to fulfill a number of costly unfunded government mandates, such as that of maintaining employment at levels estimated by some to amount to overmanning equal to 40 percent of the labor force. In effect, enterprises may have cut fringe benefit payments to pay for these unfunded mandates.

85. Larger enterprises were found to provide more of these fringe benefits than other firms and the quality of enterprise provision of these services is generally considered to be superior to comparable services provided by government. Research in other CIS countries has found that some enterprise workers collect substantial rents in providing these fringe benefits, however, thus inflating costs compared to government provision.

86. It is eminently debatable whether most of these fringe benefits should receive continued public subsidy or preferential tax treatment. There is a strong case for some government funding of the public health and kindergarten services being divested by enterprises. Enterprise divestiture of public utility services and housing is also a cause for concern during transition. As much as a quarter of total unemployment in transition economies has been attributed to the lack of labor mobility caused by unavailability of housing.

87. Those services which enterprises are divesting but which should be retained as a government functions are often assumed to be the appropriate responsibility of local governments. Local infrastructure is clearly an appropriate local government responsibility but the reasons for assigning services such as education and health to local governments are more debatable.

88. Financing arrangements have not kept pace with reassignment of functions to subnational governments, nor even with performance of their existing functions: the subnational share of total government revenues declined from 70 percent in 1992 to 48 percent in 1996. Special extrabudgetary funds have been created to finance local government operation of kindergartens and housing maintenance, however.

89. There are other problems with existing means of financing local governments. A principal difficulty with revenue sharing, which accounts for 75 percent of subnational government revenues, is that it yields more resources to wealthier regions and makes interregional imbalances worse. Tax breaks to agriculture have also reduced revenue sharing with rural local governments. There is no close link between beneficiaries and payments which would justify the use of the present extrabudgetary funds for housing maintenance and kindergartens. Too much use, in fact, is now made of extrabudgetary funds in Belarus—their revenues now exceed those on budget so that programs on the budget are not competing on a level playing field for more than half of public resources. Finally, true subnational taxes—those whose base and

rate structure are determined by subnational governments and for which the latter are responsible to their own electorates—raise insignificant amounts of revenue.

90. The financing of local utility services is most appropriately accomplished by user cost recovery, with any resulting income distributional problems being addressed by direct income support measures such as the housing allowance that the Government of Belarus has instituted. Belarus also needs effective real estate taxes to finance local government services to property: the existing land use tax has been a nuisance tax, in that it costs more to administer than it raises in revenues. Where transfers to local governments are required, formula financing is suggested. Such formula financing is appropriate for both unconditional grants to low-income local governments and conditional grants to support specific objectives such as maintaining minimum national standards in services delivered by local governments.

APPENDIX A

The Relative Burden of Wage Taxes in Belarus, the OECD and European Union

91. The argument that wage taxes levied to finance social protection programs such as pensions and unemployment compensation are of a size capable of threatening “competitiveness” of enterprises in the former command economies is frequently encountered. Payroll taxes account for 46 percent of payrolls in Belarus. The Social Protection Fund is financed by a 35 percent payroll tax, the Employment Fund is financed by a further 1 percent payroll tax and an additional 10 percent tax on payroll is levied to pay for measures to ameliorate the effects of the Chernobyl nuclear disaster. Social security levies in many CIS countries such as Russia account for slightly smaller total shares of payrolls,⁴⁹ but even payroll taxes in the range of 35 percent to 40 percent of payroll in many Eastern European countries arouse concern because of possible adverse effects on enterprise and national competitiveness.

92. A good case can be made, however, that these payroll taxes are not substantially larger than similar taxes in many Western industrial countries. Furthermore, payroll taxes may be a suitable method of financing appropriately designed social security programs.

93. The importance of payroll and social security taxes as a source of revenues in Belarus can be compared with European and OECD practice. Keen (p.4) reports that social security and payroll taxes accounted for 26.3 percent of revenues in Belarus in 1992, 25.9 percent of revenues of OECD member countries, and 29.3 percent of revenues in European Union countries.

94. The greater use made of payroll taxes by European countries is of interest from the point of view of the competitiveness hypothesis, as is the size of the effective tax rate on earnings in many of these countries. In a 1996 article, Kesselman compares effective tax rates on earnings for OECD countries. He finds that, “at earnings of USD 20,000 (noted as being near the average earnings rate in most OECD countries considered), the total average effective payroll tax rate exceeds 35 percent in 8 of the 20 countries tabulated; it exceeds 45 percent in Belgium, France, Greece and Italy.”⁵⁰

95. What might also be taken into account is the finding in the present study that payroll is only part of worker remuneration in Belarus because the “social benefits” provided by enterprises are not taxed as part of payroll, or indeed as personal income. We found that such fringe benefits amounted to 35 percent and 12 percent of wages and salaries in 1994 and 1995 in Belarus. Consequently, the “effective” (as opposed to nominal) wage tax would have amounted to only 30 percent of worker remuneration in 1994 ($.46 \times .65 = .30$) and 40 percent of worker remuneration in 1995 ($.46 \times .88 = .40$). The relevance of this calculation of effective payroll tax rates is shown by the recent decision of the Government of Russia to expand the payroll tax to include non-wage worker compensation, as indicated in a decree of January 1996.

96. It is also relevant to include income taxes in comparisons of tax burdens on wages. The personal income tax is almost exclusively a tax on wages and salaries in Belarus, is levied on a narrow base because

⁴⁹ Commander and Lee with Tolstopiatenko found that “payroll taxes and deductions comprise up to 40 percent of the wage bill” for a large sample of Russian industrial firms in 1994. See *Social Benefits and the Russian Industrial Firm*, p.3. Current *employer* contribution tax rates for social insurance in Russia appear to be 38.1% of payroll, with *employees* paying 1% of gross salary to the pension fund (information from Mark Sundberg, World Bank, EC3C2, 20 October, 1996). Kesselman reports *employer* contribution rates for Russia which were 1% lower in 1993. See Jonathan R. Kesselman, “Payroll Taxes Around the World: Concepts and Practice,” *Canadian Tax Journal* 1996, Vol. 44, No 1, p.78.

⁵⁰ *Ibid*, p.78.

of non-taxation of fringe benefits, and does not assume the importance as a revenue source that it does in OECD countries. Lumping the personal income tax together with payroll and social security taxes in his 1996 inquiry, Keen (p.6) finds that these three taxes account for 32 percent of tax revenue in Belarus compared to 55 percent of tax revenue in both the European Union and OECD countries. The differences in relation to GDP are not as marked but are still substantial. Keen finds that the three taxes account for about 16 percent of GDP in Belarus and about 21 percent in the European Union and OECD countries.

97. Finally, tax specialists who have considered the question do not view payroll taxes as an inappropriate means of financing social security programs. Kesselman concludes for example that,

Payroll taxes in general are a relatively efficient form of taxation in the long run, at least compared with taxes on income or capital. They can also be simple and low-cost to operate for both governments and taxpayers. When tied to benefits in a well-designed program of social security, payroll taxes offer the additional advantage of posing minimal distortions to labor and other economic behaviors. This potential is unlike most other forms of taxation, which have unavoidable efficiency costs.⁵¹

98. In one respect, Kesselman's conclusion suggests that our inquiry into the effects of wage taxes in the former command economies has been literally one-sided. A comprehensive assessment of the impact of wage taxes in these countries would also need to take into account the benefits obtained from the social insurance programs financed by these wage taxes.

⁵¹ Jonathan R. Kesselman, "Payroll Taxes in the Finance of Social Security," *Canadian Public Policy*, vol. 22 (June 1966), p.174.

Autonomous Sources of Revenue for OECD Local Governments: Property vs. Income Taxes

99. Where the application of direct user charges are impractical, forms of the property tax have been the traditional source of much local government finance in many parts of the world. In terms of OECD usage, the property tax is the primary (and often the only) local government tax in the Netherlands and the English-speaking countries—Australia, Canada, the United States, Ireland, New Zealand and the United Kingdom. Income taxes are more important as a source of local government revenues in other European countries and Japan. In his recent survey of OECD practice for the Bank, McMillan notes that out of 24 countries, local governments in 20 countries have property taxes and in 17 have income taxes.

100. One has to be careful, however, to ensure that local income taxes are not simply revenue sharing arrangements, where local governments have no control over the base and rate structure of the tax and are not responsible to taxpayers for funds obtained. As McMillan and Bird and Slack observe, a number of revenue sharing arrangements of this type are recorded in OECD statistics as local income taxes.⁵²

101. Table 6 shows that if one excludes income taxes identified by McMillan as revenue sharing (in Austria, Germany, Norway and Spain), revenues from property taxes exceeded revenues from local income taxes in the OECD in 1990 by 4.5 percent (USD 283 billion as opposed to USD 271 billion).

⁵² McMillan observes that "where property taxes prevail, rates are locally established. In contrast, local income tax revenues are typically shared revenues not determined by local authorities. Denmark and Sweden are exceptions demonstrating the viability of true local income taxes." Melville L. McMillan, "A Local Perspective on Fiscal Federalism: Practices, Experiences and Lessons from Developed Countries," PRDPE (processed) 1994, (p. S-1). Bird and Slack observe that "the property tax has the clear advantage from a political and accountability perspective that it is, as a rule at least, in part a locally designed and locally-implemented tax...Potentially more productive alternative "local" taxes on income and sales in most countries do not have this advantage because not only the design and administration but even the rates of these taxes are almost always determined by central, not local, authorities." Richard M. Bird and Enid Slack, "Financing Local Government in OECD Countries: The Role of Local Taxes and User Charges," in J. Owens and G. Panella eds., *Local Government: An International Perspective*, (Amsterdam: North-Holland, 1991), p. 90.

Table 6: Comparative Importance of Local Income and Property Taxes, Selected OECD Countries, 1990

Country	Income Tax	Property Tax	GDP	Income Tax	Property Tax
	As Percentage of GDP		(USD Million)		
Australia	-	1.1	296,300	-	3,259
Austria	[2.0]	0.4	157,380	[3,148]	630
Canada	-	2.8	570,150	-	15,964
Switzerland	4.7	0.7	224,850	10,568	1,574
USA	0.2	2.9	5,392,200	10,784	156,374
Belgium	1.6	-	192,390	3,078	-
Denmark	14.4	1.1	130,960	18,858	1,441
Finland	10.9	0.1	137,250	14,960	137
France	0.5	1.5	1,190,780	5,954	17,862
Germany	[2.7]	0.6	1,498,210	[40,452]	8,989
Iceland	4.5	1.2		-	-
Ireland	-	1.0	42,500	-	425
Italy	0.7	-	1,090,750	7,635	-
Japan	5.3	1.9	2,942,890	155,973	55,915
Netherlands	-	0.8	279,150	-	2,233
New Zealand	-	1.9	42,760	-	812
Norway	[9.0]	0.9	105,830	[9,525]	952
Portugal	0.4	0.8	56,820	227	455
Spain	[0.8]	2.0	491,240	[3,930]	9,825
Sweden	17.9	-	228,110	40,832	-
Turkey	1.8	0.1	96,500	1,737	97
United Kingdom	-	0.6	975,150	-	5,851
Total				270,607	282,794

Sources: World Development Report, 1992 and McMillan, Table 5.

NOTE: Income taxes for countries whose rates are indicated in brackets were treated as revenue sharing and not included in the calculations.

BIBLIOGRAPHY

- Belarus, Ministry of Statistics and Analysis. 1996. *Expenditures and Income of the Population in Belarus: 1995*. Minsk.
- Bird, Richard M. and Enid Slack. 1991. "Financing Local Government in OECD Countries: The Role of Local Taxes and User Charges." In J. Owens and G. Panella eds., *Local Government: An International Perspective*. Amsterdam: North-Holland.
- _____ and Thomas Tsiopoulos. 1994 (May). "Taxation and the Development of Private Enterprise in Belarus." World Bank (EC4C1).
- Bodnar, Patrick, Lev Freinkman, Vladimir Lexin and Alexander Shvetsov. 1996 (June). "Russia: Financing and Maintenance of Social Assets Divested from the Coal Industry." World Bank (EC3C2).
- Buckley, Robert M. and Eugene M. Gorenko. 1995 (June). "Unwinding the Socialist Wage Package: The Role of Housing in Russia." World Bank (TWURD).
- Cheasty, Adrienne. "Social Divestiture in Ukraine—A Budgetary Perspective." 1995 (October). IMF Fiscal Affairs Department.
- Commander, Simon and Richard Jackman. 1993. "Providing Social Benefits in Russia: Redefining the Roles of Firms and Government." World Bank Policy Research Working Paper 1184.
- _____ and Une Lee with Andrei Tolstopiatenko. 1995. "Social Benefits and the Russian Industrial Firm." In *Russia: Economic Policy and Enterprise Restructuring*. Joint Conference of the World Bank and the Ministry of Economy of the Russian Federation.
- Coricelli, Fabrizio, Krzysztof Hagemeyer and Krzysztof Rybinski. 1995. "Poland." In Simon Commander and Fabrizio Coricelli (eds), *Unemployment, Restructuring, and the Labor Market in Eastern Europe and Russia*. EDI Development Studies. Washington, DC, The World Bank.
- Economic Council of Canada. 1987. *The Taxation of Savings and Investment*. Ottawa, Ontario: Minister of Supply and Services Canada.
- Freinkman, Lev M. and Irina Starodubrovskaya. 1996. "Restructuring of Enterprise Social Assets in Russia," World Bank Policy Research Working Paper 1635.
- Gruber Jonathan and James Poterba. 1995 (June). "Tax Subsidies to Employer-Provided Health Insurance," NBER Working Paper No. 5147.
- Horioka, Charles Yuji. 1994 (January). "Japan's Consumption and Saving in International Perspective." *Economic Development and Cultural Change*, 42 (2).
- Keen, Mick. 1996 (April). "Tax Reform in Belarus: Preliminary Report on Economic Aspects." EU-Tacis.
- Kesselman, Jonathan R. 1996 (May) "Payroll Taxes Around the World: Concepts and Practice." *Canadian Tax Journal* 44 (1): 59-84.
- _____. 1996 (June). "Payroll Taxes in the Finance of Social Security." *Canadian Public Policy*. 22: 162-179.
- Khankevich, L.A. 1996 (June). "The Taxation System in the Republic of Belarus." World Bank (EC4C1).
- Kitchen, Harry. 1993. *Efficient Delivery of Local Government Services*. School of Policy Studies Discussion Paper No. 93-15. Kingston, Ontario: Queen's University.

- Klugman, Jeni, Sheila Marnie, John Micklewright and Philip O'Keefe. 1996 (forthcoming). "Enterprise Divestiture of Kindergartens and Childcare Arrangements in Central Asia." In Jane Falkingham, Jeni Klugman, Sheila Marnie and John Micklewright (eds), *Household Welfare in Central Asia*. Macmillan, U.K.
- Kuraishi, Mari and Lev Freinkman. 1995 (May). "Russia: Enterprise Restructuring and Social Asset Divestiture." Notes for World Bank/IMF/EBRD Meeting.
- Martinez-Vasquez, Jorge. 1994. "The Challenge of Expenditure-Assignment Reform in Russia," *Journal of Environment and Planning*. 12: 277-292.
- McMillan, Melville L. 1995. *A Local Perspective on Fiscal Federalism: Practices, Experiences and Lessons from Developed Countries*. World Bank (PRDPE).
- Schaffer Mark E., Richard Jackman, Gaspar Fajth and Judit Lakatos, Martin Rein, Irina Tratch and Andreas Woergoetter. 1995. "Round table on 'Divestiture of Social Services from State-Owned Enterprises.'" *Economics of Transition*. 3 (2): 247-266.
- Urban Institute. 1995. "Russian Enterprise Housing Divestiture." Urban Institute Research Paper.
- Wallich, Christine I. 1994. "Russia's Dilemma." In Christine I. Wallich ed., *Russia and the Challenge of Fiscal Federalism*. Washington, DC: World Bank Regional and Sectoral Study: 1-18.
- Woodbury, Stephen A. and Daniel S. Hamermesh. 1992 (May). "Taxes, Fringe Benefits and Faculty", *The Review of Economics and Statistics*. LXXIV (2): 287-296.
- World Bank. 1994. *World Development Report, 1994*. Washington, DC
- _____. 1996 (June). *Belarus: An Assessment of Poverty and Prospects for Improved Living Standards*. (EC4C1).
- _____. 1996. "Conditional Grants: International Experience." Annex 4, World Bank Country Study. Fiscal Management in the Russian Federation: 141-145

Policy Research Working Paper Series

Title	Author	Date	Contact for paper
WPS1705 The Polish Experience with Bank and Enterprise Restructuring	Fernando Montes-Negret Luca Papi	January 1997	T. Ishibe 38968
WPS1706 Monetary Policy during Transition: An Overview	Martha de Melo Cevdet Denizer	January 1997	C. Bernardo 37699
WPS1707 Trade Reorientation and Productivity Growth in Bulgarian Enterprises	Simeon Djankov Bernard Hoekman	January 1997	J. Ngaine 37947
WPS1708 Has Latin America's Post-Reform Growth Been Disappointing?	William Easterly Norman Loayza Peter Montiel	January 1997	R. Martin 31320
WPS1709 Poverty Comparisons with Noncompatible Data: Theory and Illustrations	Jean Olson Lanjouw Peter Lanjouw	January 1997	A. Ramirez 85734
WPS1710 Why Paper Mills Clean Up: Determinants of Pollution Abatement in Four Asian Countries	Raymond S. Hartman Mainul Huq	January 1997	D. Wheeler 33401
WPS1711 Issues in Comparing Poverty Trends Over Time in Côte d'Ivoire	Christine Jones Xiao Ye	January 1997	R. Martin 31320
WPS1712 Demand Elasticities in International Trade: Are They Really Low?	Arvind Panagariya Shekhar Shah Deepak Mishra	December 1996	J. Badami 80425
WPS1713 Why Did Colombian Private Savings Decline in the Early 1990s?	Alejandro López	January 1997	E. Khine 37471
WPS1714 Fiscal Federalism in Bosnia-Herzegovina: The Dayton Challenge	William Fox Christine Wallich	January 1997	Y. Jiwa 34848
WPS1715 The Evolution of Poverty and Welfare in Nigeria, 1985-92	Sudharshan Canagarajan John Ngwafon Saji Thomas	January 1997	B. Casely-Hayford 34672
WPS1716 Reforming Pensions in Zambia: An Analysis of Existing Schemes and Options for Reform	Monika Queisser Clive Bailey John Woodall	January 1997	H. Arbi 34663
WPS1717 Fiscal Federalism in Bosnia-Herzegovina: The Dayton Challenge	William Fox Christine Wallich	January 1997	Y. Jiwa 34848
WPS1718 Does Environmental Regulation Matter? Determinants of the Location of New Manufacturing Plants in India in 1994	Muthukumara Mani, Sheoli Pargal, and Mainul Huq	February 1997	E. de Castro 89121

Policy Research Working Paper Series

Title	Author	Date	Contact for paper
WPS1719 Shifting Responsibility for Social Services As Enterprises Privatize in Belarus	David Sewell	February 1997	C. Lawrence 32216